

**Reply Affidavit of  
William C. Deere**

**AFFIDAVIT OF WILLIAM C. DEERE**

STATE OF TEXAS                                 )  
  )       SS  
CITY OF DALLAS                                 )

**WILLIAM C. DEERE**, being duly sworn, deposes and says:

1. My name is William C. Deere. I am currently employed as Executive Director Planning and Engineering for Southwestern Bell Telephone Company ("SWBT"), with similar responsibility for Pacific Bell ("PacBell") and Nevada Bell. I make this affidavit to address certain discrete issues regarding access and interconnection to SBC Communication Inc.'s ("SBC") public switched networks by interexchange carriers ("IXCs") and competitive local exchange carriers ("CLECs").

## Qualifications

2. I have a Bachelor of Science, Electrical Engineering degree from Southern Methodist University in Dallas, Texas. I am also a Registered Professional Engineer in Texas and have completed numerous training courses, including those conducted by the Bell System, AT&T, Northern Telcom, Ericsson, and SWBT on switching systems, transmission systems, and local network distribution systems.
3. I have over 37 years experience in the telecommunications industry. I began as a Student Engineer with Southwestern Bell in 1961. I worked in the central office and the PBX engineering groups of the Engineering department until October 1969. At that time I was transferred to the Traffic Department where I worked as the Manager-Switching Design and then the Traffic Manager Network Design where I supervised the

PBX design group for the north part of Texas until October 1978. I worked in St. Louis for 18 months as the head of the Business Services staff, and then returned to Dallas as the Division Manager-Network Administration. In October 1984, I assumed the duties of Division Staff Manager-Network Planning Staff. My title was changed to Division Manager-Network Engineering (Customer Services) on October 1, 1986, as a result of a reorganization of the Texas Network department. In October 1993, I became Regional Manager Planning and Engineering, first for the five states served by SWBT and then for the seven states served by SWBT, PacBell, and Nevada Bell. My title changed to Executive Director Planning and Engineering in September 1998.

4. In addition, through my experiences as Executive Director Planning and Engineering and my past positions, I am familiar with investments and substantive efforts by SBC to improve access services in general, including in the Pacific Telesis region.

#### Discrimination Generally

5. Neither SBC nor any other incumbent local exchange carriers ("ILECs") has any practical or undetectable way to discriminate in favor of itself or its affiliates, or against IXC's or CLEC's in the provision and maintenance of access services. Discrimination would require identification of a particular call as one of a customer of a competitor and then implementation of some call quality alteration that would cause the customer to change carriers. None of the several steps involved are possible, practical, or could go undetected. First, a database of customers must be kept up-to-date; however, in today's competitive world where consumers switch carriers all the time, it is not realistically possible or practical. Second, each of the tens of billions of calls a year

would need to be screened against the database. Third, some alteration of call quality would be required, either degradation (to an IXC's or CLEC's service) or improvement (to SBC's or an ILEC's service), and it would have to be significant enough to cause customers to switch carriers, but insignificant enough to avoid detection by the IXCs and the regulators.

6. Such a scheme is not technically possible because SBC (like other ILECs) provides IXCs and CLECs with exchange access, network interconnection, and resold services using the same network facilities, systems, and databases that the ILECs use to serve their own retail customers. These facilities, switches, and systems were designed specifically to provide nondiscriminatory service, making systematic discrimination impossible without massive and fundamental network modification and/or replacement.

#### Technological Developments in the Network Do Not Provide Ability to Discriminate

7. Advances in network technology such as common channel signaling ("CCS"), Signal System 7 ("SS7") protocol, Intelligent Network Elements ("INE"), Advanced Intelligent Network ("AIN"), and Asynchronous Transfer Mode ("ATM") switching, do not provide ILECs an ability to discriminate.
8. None of these advanced network elements (or any other technologically advanced network elements) provides a means for permitting call degradation on selected calls sufficient to cause consumers to switch service. These technologies generally allow ILECs to provide consumers with more advanced services, and to do it more quickly and for less money. There is nothing inherent in the technologies that facilitates discrimination. For example, signaling advances, including increased deployment of

SS7 protocol, provide consumers with numerous new services by allowing carriers to exchange call control information efficiently and independent of the call. (Signaling is transmission of call control information, *e.g.*, set up, disconnecting, etc., which is necessary for routing and properly billing a call.) Similarly, AIN allows for calls to be routed more efficiently and allows ILECs to develop and implement new and customized services more quickly and cheaply by removing the need that network hardware be replaced before such services could be offered. Furthermore, any attempt to discriminate, even with these advanced network elements, would be identifiable and detectable because of, among other things, the time delays that would be incurred.

9. With regard to the signaling network in particular, ILECs provide access to their signaling network to IXC and CLECs as part of their interconnection agreements, and provide such access under the same terms and conditions to all. Moreover, the same switches, signal transfer points, signaling links, signaling protocols, and routing tables that SBC uses for itself are used to provide signaling for CLECs. Therefore, efforts to degrade the quality of competitor's calls would inevitably degrade the calls of our own customers as well.

#### IXC Monitoring of SBC Access Service

10. Finally, any attempted discrimination against IXCs would be easily and quickly (if not immediately) detected because IXCs and CLECs routinely deploy automatic test equipment and performance monitoring devices that provide general quality assurance functions. Also, the ILECs provide test lines that can be used by the IXCs and CLECs

to test individual lines and trunks at any time without the aid of ILEC technicians.

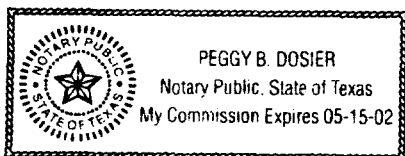
Thus, any attempt by an ILEC to discriminate would promptly be detected.

11. In addition, many IXCs have established their own expectations about the level of service provided and have monitoring schemes to ensure that their expectations are met. For example, AT&T has an extensive and detailed monitoring and feedback process. AT&T's plan covers all phases of the ILECs' operations relating to the provision of switched and special access services to AT&T, measuring over 100 performance items each quarter, and AT&T provides a report (also known as a "report card") to the ILECs on its performance each quarter. Included are such items as Access Network Reliability, maintenance of test lines, installation of test lines, SS7 network performance, percent of trunk groups exceeding AT&T's specified grade of service, due dates not met, and many other measures of interoffice transport performance. Any change in the level of service being provided to AT&T by ILECs would certainly be detected during this routine monitoring of service.
12. Incidentally, these testing and monitoring efforts are in addition to those imposed on ILECs under their respective FCC Access Tariffs, which, among many other things, incorporate specifications for transmission quality, provide acceptance and in-service tests to be performed cooperatively between the ILECs and the IXCs, and require that access test facilities be available to the IXCs.
13. Through their routine and extensive monitoring efforts, IXCs often recognize SBC's efforts to improve the quality of access service. For example, AT&T (SBC's largest

customer) stated in SBC's report card for the first quarter of 1998 that, while Pacific Bell's special service provisioning at the time did not meet AT&T's expectations,

[t]hroughout the first quarter of 1998, SBC - Pacific's leadership and the SBC - Pacific AT&T account management team remained focused on their 1998 quarter over quarter commitments. The Gap closure initiatives, designed to provide AT&T the same level and quality of service in California that AT&T enjoys with SBC, performed at the forecasted level.

14. Thus, AT&T found that the quality of access services provided by PacBell improved following the SBC - Pacific Telesis merger, as SBC worked to increase the quality of access services in California to that provided in SBC's historical service area.



  
William C. Deere

Subscribed and sworn to before me this 1<sup>st</sup> day of November, 1998.

  
Notary Public

**Reply Affidavit of  
Dennis W. Carlton**



## **REPLY AFFIDAVIT OF DENNIS W. CARLTON**

1. I, Dennis W. Carlton, am Professor of Economics at the Graduate School of Business of the University of Chicago. In addition to my academic experience, I am President of Lexecon Inc., an economics consulting firm specializing in the application of economics to legal and regulatory issues. On July 20, 1998, I submitted an affidavit and report to the FCC relating to the proposed transaction. That statement contains a complete statement of my qualifications as well as my curriculum vitae.

2. I have been asked by SBC to review the comments on the proposed SBC/Ameritech merger filed with the FCC on October 16, 1998 and to respond to various claims in those statements. Due to the large number and broad scope of the comments submitted to the FCC, this reply focuses on statements made by the major interexchange carriers, AT&T, Sprint and MCI WorldCom, and the affidavits submitted in support of their statements. Given the substantial overlap between the comments made by interexchange carriers and others, these reply comments also respond to many of the statements made by others.

3. This report addresses opponents' claims that the proposed transaction will not yield benefits to consumers. More specifically, I respond to opponents' claims that SBC and Ameritech each would undertake a National/Local plan or a similar strategy absent the proposed merger and, as a result, benefits resulting from the National/Local plan cannot be considered a merger-specific efficiency. I also address opponents' arguments that other efficiencies that SBC and Ameritech claim will result from the proposed transaction are not merger-specific.

4. I conclude that the National/Local strategy and other efficiencies that SBC and Ameritech claim will result from the proposed transaction are merger-specific and will benefit

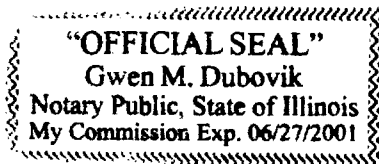
consumers. The consequence of blocking the proposed transaction will be to benefit the opponents of the merger and to deny consumers the benefits of increased competition.

5. The attached report contains the results of my analysis and the bases for my conclusion.

Dennis W. Carlton  
Dennis W. Carlton

Subscribed and sworn to before me  
this day of November 12, 1998

Gwen M. Dubovik  
Notary Public



**REPLY REPORT OF DENNIS W. CARLTON**

**CC Docket No. 98-141**

**November 12, 1998**

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## **I. INTRODUCTION AND OVERVIEW**

### **A. QUALIFICATIONS AND PURPOSE**

1. I, Dennis W. Carlton, am Professor of Economics at the Graduate School of Business of the University of Chicago. In addition to my academic experience, I am President of Lexecon Inc., an economics consulting firm specializing in the application of economics to legal and regulatory issues. On July 20, 1998, I submitted an affidavit and report to the FCC relating to the proposed transaction. That statement contains a complete statement of my qualifications as well as my curriculum vitae.

2. I have been asked by SBC to review the comments on the proposed SBC/Ameritech merger filed with the FCC on October 16, 1998 and to respond to various claims in those statements. Due to the large number and broad scope of the comments submitted to the FCC, this reply focuses on statements made by the major interexchange carriers, AT&T, Sprint and MCI WorldCom (hereafter, opponents), and the affidavits submitted in support of their statements.<sup>1</sup> Given the substantial overlap between the comments made by interexchange carriers and others, my reply comments also respond to many of the statements made by others.

3. This report addresses opponents' claims that the proposed transaction will not yield benefits to consumers. More specifically, I respond to opponents' claims that SBC and Ameritech each would undertake a National/Local plan or a similar strategy absent the proposed merger and, as a result, benefits resulting from the National/Local plan cannot be

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<sup>1</sup> Petition to Deny of Sprint Communications Company L.P., October 15, 1998 (hereafter, Sprint Petition); Comments of MCI WorldCom, Inc., October 15, 1998 (hereafter, MCI WorldCom Comments); Petition of AT&T Corp. to Deny Applications, October 15, 1998 (hereafter, AT&T Petition).

considered a merger-specific efficiency. I also address opponents' arguments that other efficiencies that SBC and Ameritech claim will result from the proposed transaction are not merger-specific.

**B. OVERVIEW OF REPLY TO OBJECTIONS RAISED BY OPPONENTS REGARDING THE NATIONAL/LOCAL PLAN AND THE BENEFITS OF THE PROPOSED TRANSACTION**

4. My earlier affidavit discussed how the proposed transaction would result in the creation of a new end-to-end supplier offering packages of telecommunications services to multilocation business customers. I also discussed how the merger and National/Local plan would benefit residential and small business customers. The opponents to this transaction deny that the proposed transaction will benefit consumers and instead claim that consumers will be harmed. This affidavit demonstrates that the opponents are wrong.

5. The desire of opponents, such as AT&T, MCI WorldCom and Sprint, to block this transaction is easily understood. Each of these firms, as well as other CLECs, would face increased competition from the new national provider of telecommunications services that would be created through this transaction. AT&T, MCI WorldCom, and Sprint have achieved, or are attempting to achieve, the scale and scope that SBC/Ameritech seeks in order to provide packages of sophisticated telecommunications services to large business customers and others. The consequence of blocking the transaction will be to benefit the opponents but to deny consumers the benefits of increased competition. The support expressed by customers for this transaction belies opponents' claims that the transaction will harm competition.

6. My major conclusions regarding opponents' claims about consumer benefits resulting from the proposed transaction are as follows:

- Opponents recognize the economic logic of SBC's National/Local Strategy and the need for firms to achieve the appropriate scale and scope to offer packages of end-



to-end services on a national basis. The mergers recently undertaken by opponents reflect the same logic that underlies SBC/Ameritech's National/Local plan.

- Opponents incorrectly suggest that SBC and Ameritech separately would have pursued significant out-of-region strategies absent the proposed merger. Available evidence conclusively refutes this suggestion. As a result, SBC's National/Local strategy should be considered to be a merger-specific efficiency.
- Opponents confuse the ability to finance an out-of-region strategy with the incentive to do so.
- Even if, contrary to available evidence, SBC and Ameritech each would have pursued a significant out-of-region entry plan absent the merger, opponents do not dispute that the merger accelerates deployment of such a strategy.
- In contrast to opponents' claims, SBC has made a strong and credible commitment to rapidly deploy the National/Local plan. SBC is now incurring significant costs in planning the deployment of the National/Local plan and has committed to start deploying facilities immediately following the transaction's closing.
- Opponents ignore significant additional benefits resulting from the proposed transaction, such as the procompetitive response from RBOCs and other firms that is already being observed in the marketplace. There is no basis for opponents' claim that the transaction would result in collusion among RBOCs.
- Opponents are incorrect in claiming that the other efficiencies claimed by SBC are unrealistic or otherwise are not merger-specific. SBC's success in realizing efficiencies from its merger with Pacific Telesis provides evidence that its current efficiency claims are credible.
- Opponents have no basis to conclude that the proposed transaction will result in less R&D and slow the deployment of a variety of new products and services.

7. In sum, the proposed transaction will create a significant new national provider of packages of telecommunications services that will compete with AT&T, MCI WorldCom and Sprint. These firms' opposition to the merger is understandable given the increased competition they will face.

**II. OPPONENTS INCORRECTLY CLAIM THAT THE NATIONAL/LOCAL PLAN IS NOT A MERGER-SPECIFIC BENEFIT OF THE TRANSACTION.**

**A. DESPITE OPPONENTS' CLAIMS THAT THE PROPOSED TRANSACTION WILL NOT BENEFIT CONSUMERS, THEIR STATEMENTS, AS WELL AS THOSE OF ANALYSTS, THE FCC AND CUSTOMERS, RECOGNIZE THE COMPELLING ECONOMIC LOGIC BEHIND SBC'S NATIONAL/LOCAL PLAN.**

8. Although opponents argue that consumers will not benefit from the proposed transaction, they all recognize that the economic rationale for the plan is compelling. As discussed in SBC/Ameritech's application, the National/Local strategy is motivated by a desire to offer packages of telecommunications services on an end-to-end basis nationwide. Opponents do not dispute that there is a strong and emerging demand for such services. The growing importance of such services is also recognized by industry analysts, the FCC, and consumers.

9. MCI WorldCom's comments, for example, directly acknowledge the growing demand for packages of telecommunications services for multilocation customers:

SBC and Ameritech correctly recognize that there is a demand for 'national local' or 'regional local' service: some large businesses that have multiple locations prefer to purchase local and long - distance service from a single source.<sup>2</sup>

10. A recent MCI WorldCom advertisement even more forcefully stresses the importance of providing single-network coverage for multilocation customers:

One end-to-end network not only means one contract (with better volume discounts, because all services are combined into one

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<sup>2</sup> MCI WorldCom Comments, p. 11.

account), which is an obvious advantage. It also means you always know who is responsible.<sup>3</sup>

11. AT&T also recognizes the importance of offering packages of services to multiple location customers. In a press release announcing its acquisition of Teleport Communications Group (TCG), AT&T states:

TCG's services enhance AT&T's ability to provide integrated end-to-end services for large and small business customers. AT&T will offer single points of contact for local and long-distance services and customer care, enterprise solutions for businesses with multiple locations, volume discounts across services and an integrated bill for customers who want it.<sup>4</sup>

12. Despite Sprint's claims in its brief that SBC's National/Local plan "defies commercial realities,"<sup>5</sup> Sprint's supporting affidavits stress the importance of end-to-end service at multiple locations:

Sprint's new ION service integrates voice TDM traffic, Internet traffic, Frame Relay traffic, and other data traffic on one customer access facility. ... Sprint ION service will be capable of carrying the traffic of Sprint ION customers over any distance, whether the communication is delivered within a city, across a state, or across the nation, without regard to artificial regulatory boundaries.<sup>6</sup>

13. Sprint's supporting affidavits also emphasize the benefits of suppliers' providing services on an end-to-end basis over an integrated network:

The integrated facility also will facilitate increased functionality and flexibility for communications between locations served by Sprint ION. ... [T]he value of the increased functions and features at the originating end of the transmission is, of course, constrained by the capabilities at the terminating end. The full functionality of ION will be available to ION subscribers only.<sup>7</sup>

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<sup>3</sup> MCI WorldCom advertising supplement to the Wall St. Journal, October 1, 1998, p. R3.

<sup>4</sup> AT&T press release announcing completion of merger with TCG, July 23, 1998.  
<<http://www.att.com/press/0798/980723.chb.html>>

<sup>5</sup> Sprint's petition (p. 48-9) claims that since many large customers use dual suppliers and since SBC/Ameritech will not provide network coverage in all areas, the logic of the National/Local plan "defies commercial realities." However, many customers, including those who use dual suppliers and those that have some off-net locations, prefer national suppliers to provide much (if not all) of their service needs. The National/Local plan will enable SBC to compete for these customers.

<sup>6</sup> Affidavit of Kevin Brauer, President of Sprint National Integrated Services, p. 3.

<sup>7</sup> Affidavit of Gene Agee, Director of Finance of Sprint National Integrated Services, p. 11.

14. Analysts that track the telecommunications industry also recognize the benefits of providing end-to-end services for multilocation customers. For example, CIBC Oppenheimer stated:

The proposed merger with Ameritech signals the company's aggressive pursuit of attaining national/international scale, which would uniquely position SBC among its peers to provide end-to-end services for large businesses on a global basis.<sup>8</sup>

15. Similarly, the FCC recognizes the growing importance of bundling services to multiple location customers and the ability of mergers to enhance the ability of firms to offer these services. The FCC's order in the MCI-WorldCom merger stated:

We also find persuasive Applicants' assertions that the merger will allow them to service multi-location customers over their own networks, and that this will enable such customers to receive higher quality and more reliable services than each company is currently able to offer separately.<sup>9</sup>

16. Customers will be the final arbiters of whether SBC's National/Local strategy is economically sensible. As discussed in my prior affidavit, this transaction is a sensible response to the perceptions of SBC and others about: (i) the increasing importance to consumers of packages of end-to-end services provided by a single supplier on a national basis; and (ii) SBC's inability to meet customer demand for such services due to limitations on its size and scope. My prior affidavit identified various examples of customers with demands that SBC was unable to meet. Since my last affidavit, Ameritech has also identified several examples of customers for which it has been unable to compete successfully with the national interexchange carriers in providing multilocation services. Examples of such customers, and the telecommunication firms that eventually won these contracts, include Chrysler (MCI), K-Mart (AT&T), Bank One (AT&T), UPS (AT&T), U.S. Postal Service (MCI), Household Finance (MCI/AT&T) and others. Ameritech attributes its failure to win contracts such as these to its

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<sup>8</sup> CIBC Oppenheimer, "SBC Communications," September 11, 1998, p. 2.

<sup>9</sup> MCI-WorldCom Order, ¶199.

inability to offer a national billing, provisioning and service capability and its inability to offer a full range of services.<sup>10</sup>

17. Customers also recognize the economic logic motivating the proposed merger and National/Local strategy. For example, in a letter to the FCC dated October 12, 1998, Ultramar/Diamond Shamrock writes:

To date, we have not considered SBC as a potential provider of services to all of our locations. With the combination of SBC-Ameritech and the launch of the "Thirty Cities Strategy," SBC will potentially be offering service to the large majority of our locations. With this significant amount of coverage, we will finally be able to consider SBC as a candidate to be our strategic source of telecommunications services.

**B. THE RATIONALE FOR THE MERGER AND OUT-OF-REGION STRATEGY IS RECOGNIZED IN OTHER RECENT AND PROPOSED MERGERS.**

18. Opponents claim that the proposed transaction is not necessary for SBC and Ameritech to provide packages of telecommunications services on an end-to-end basis nationwide. However, opponents' actions speak louder than their words on this score. AT&T's acquisition of TCG and proposed acquisition of TCI, WorldCom's acquisitions of MCI, MFS, Brooks, UUNet, and others, as well as Bell Atlantic's proposed merger with GTE, all are motivated by the recognition that mergers can permit firms to achieve the scale and scope necessary to provide national services. The rationale for these mergers is very similar to those expressed by SBC and Ameritech:

- In describing its rationale for acquiring TCG, AT&T stated that it "... expects that the acquisition of TCG will enhance AT&T's ability to provide end-to-end service to broader classes of customers."<sup>11</sup>

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<sup>10</sup> Examples provided by William Cannon, General Manager, Sales, Ameritech Advanced Data Services.

<sup>11</sup> AT&T-TCG, Application for Authority to Transfer Control, p. 8.

- In describing its acquisition of TCI, AT&T stated that “the Merger Parties plan to be the first fully-integrated residential communications services provider with a national product including the ability to provide long distance, video, local, wireless, Internet and other data services on a packaged, as well as individualized, basis.”<sup>12</sup>
- In describing its motivation for acquiring MCI, WorldCom stated that “[t]he combination of advanced fiber-based local city networks, high capacity transoceanic cables, and state-of-the-art global long distance and data networks well position the combined company to become a pre-eminent provider of advanced one-stop-shopping telecommunications services.”<sup>13</sup>
- While it is not opposing the proposed merger, Bell Atlantic/GTE’s public interest statement also recognizes the logic of SBC’s “follow the customer” strategy: “Bell Atlantic’s business customers from the Northeast provide a legion of anchor customers – through those businesses’ branch offices – in many cities across the Nation.”<sup>14</sup>

19. Thus, despite opponents’ repeated claims that the proposed merger will not benefit consumers, their actions indicate that the plan is sensible, and even necessary, to respond to industry demand.

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<sup>12</sup> AT&T-TCI Description of Transaction, Public Interest Showing, and Related Demonstration, p. 38-39.

<sup>13</sup> MCI-WorldCom, Application and Request for Special Temporary Authority, pp. 9-10.

<sup>14</sup> Bell Atlantic/GTE Public Interest Statement, p. 7.

**C. THERE IS NO BASIS FOR OPPONENTS' CLAIM THAT SBC AND AMERITECH WOULD HAVE PURSUED SIGNIFICANT OUT-OF-REGION ENTRY ABSENT THE PROPOSED MERGER.**

**1. Opponents' claim that SBC and Ameritech independently would pursue the same strategy as the merged firm reflects flawed economic logic.**

20. Opponents argue that the benefits to consumers resulting from SBC's National/Local strategy should not be attributed to the merger because SBC and Ameritech independently would have pursued significant out-of-region entry absent their proposed merger. They argue that if such a strategy is profitable for the merged firm, it also would have been profitable for SBC and Ameritech separately.

21. Opponents' logic is flawed. What is profitable for the merged SBC/Ameritech is not necessarily profitable for each firm independently. My earlier affidavit identified several ways in which the merger increases the merged firm's ability and incentive to undertake an out-of-region strategy, including: (i) increasing the number of in-region customers for which the merged firm could provide nearly national coverage; (ii) reducing the number of cities in which facilities need to be deployed in order to provide a national footprint; and (iii) providing a larger base of skilled managerial and technical resources that can be used in deploying services while maintaining service quality for existing customers. Therefore, the expected profitability of the National/Local plan with the proposed merger does not, as opponents suggest, imply that the strategy also would be profitable absent the merger.

**2. Opponents confuse the ability to finance out-of-region entry and the incentive to do so.**

22. Opponents argue that SBC would have deployed facilities and services outside its home region absent the merger because SBC could afford such an investment. While SBC may be able to finance an out-of-region strategy in the absence of the proposed transaction, this

does not imply that it would do so. Many firms have the ability to do so, but few have the incentive.<sup>15</sup>

23. As discussed above, and in my first affidavit, the facts are that neither SBC, Ameritech, nor any other RBOC to date has pursued significant out-of-region local exchange strategies. This strongly suggests that neither SBC nor Ameritech has a profitable incentive to undertake such a strategy (absent the proposed transaction). What is profitable for the merged SBC/Ameritech is not necessarily profitable for each firm separately (even if each firm independently could finance an out-of-region program). The failure of SBC, Ameritech and other RBOCs to pursue such significant out-of-region entry provides strong evidence that such a strategy is unprofitable absent the proposed transaction.

**3. There is no evidence that either SBC or Ameritech would pursue a significant out-of-region strategy absent the proposed transaction.**

24. Opponents' claim that SBC and Ameritech each would have pursued the same strategy absent the transaction is sheer speculation. No opponent offers any evidence whatsoever that either SBC or Ameritech (or other RBOCs) would pursue a significant out-of-region strategy absent the transaction. Opponents, in effect, ask the FCC to ignore marketplace evidence and accept the opponents' business judgement instead.

25. The conclusion that the National/Local strategy would not be pursued absent the proposed transaction is further reinforced by the fact that SBC's and Ameritech's limited out-of-region local exchange efforts, quite simply, have not succeeded to date and there is no reason to expect that these circumstances would change in the foreseeable future.

- SBC planned to provide out-of-region local services in areas in which it provided cellular services. These efforts were abandoned when a pilot program failed to

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<sup>15</sup> It is my understanding that SBC has never claimed that it would be unable to raise the capital needed to undertake the National/Local plan in the absence of the proposed transaction. (See Kahan Reply Affidavit.)



attract target customers that were intensive users of long distance and vertical services.<sup>16</sup>

- Ameritech also considered providing local services in the only out-of-region cellular territory it served – St. Louis. This strategy was based on resale of SBC service and Ameritech had no plans to build network facilities in the area.<sup>17</sup>
- Ameritech's attempt to "follow" customers by providing local service out-of-region succeeded in winning only one customer -- United Airlines. These efforts resulted in Ameritech reselling local service for only 600 local lines in Texas, California and New York. Ameritech is no longer attempting to follow other customers out of its home region.<sup>18</sup>

26. The lack of success of these efforts to date indicates that there is no basis to opponents' claims that SBC and Ameritech would deploy a significant out-of-region local exchange strategy in the absence of the proposed transaction.

**4. Opponents fail to recognize that it is unlikely that SBC and/or Ameritech could have pursued the National/Local strategy based on resale and/or rebundled network elements.**

27. Opponents suggest that SBC or Ameritech could offer service outside their home territories "without the merger by relying on facilities leased from the incumbent LECs or other suppliers of capacity."<sup>19</sup> It is unlikely, however, that such a strategy could achieve the goals of the National/Local plan.

28. While out-of-region entry based on resale of incumbents' services and/or rebundling of network elements may require less capital investment than a facilities-based strategy, it is unlikely that SBC or Ameritech could achieve the objectives of the National/Local

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<sup>16</sup> Sigman Affidavit, ¶¶3-7.

<sup>17</sup> Osland Affidavit, ¶7.

<sup>18</sup> Weller Affidavit, ¶32.

<sup>19</sup> Declaration of Besen, Sringagesh, and Woodbury on behalf of Sprint, p. 13.

strategy by offering non-facilities based out-of-region services on a broad-scale basis, even if changes in the legal and regulatory environment facilitated non-facilities based entry.

29. For example, provision of services based on resale of incumbents' services or rebundling of incumbents' network elements would not allow SBC to exercise the "end to end" control of network facilities that current service providers emphasize in promoting their services.<sup>20</sup>

30. As discussed in SBC's and Ameritech's application, the National/Local strategy will first target multilocation business customers. These are precisely the customers that have specialized requirements and desire similar services at all locations. Such requirements cannot be met through resale and/or rebundling network elements offered by incumbent suppliers.

31. Analysts stress the importance of facilities-based deployment in providing the customized services demanded by large business customers:

SBC and Sprint ION's CLEC networks will use a combination of leased and owned urban SONET rings, but own their local network switches and network management facilities, since these provide product and feature differentiation.<sup>21</sup>

32. Other CLECs have also emphasized the importance of entrants providing their own facilities. For example, an official of NextLink emphasized that:

... the key to competition is to have facility based providers putting facilities in place providing differentiated service to the customers. It is the way to provide a customized service to the consumer. It is a way to ensure you can provide service a lower cost than is currently provided by the incumbent local exchange carrier. We believe it is the best way to fulfill the goal of the Act.<sup>22</sup>

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<sup>20</sup> See Section II.B.

<sup>21</sup> Dresdner, Kleinwort Benson Research, "AT&T, Sprint and MCI WorldCom," August 20, 1998, p. 22.

<sup>22</sup> Gerry Salemme, Senior Vice-President, NextLink, FCC Common Carrier Bureau Forum: Combinations of Unbundled Network Elements, June 4, 1998, p. 22.

**5. In sum, there is no evidence that SBC or Ameritech would have pursued a significant out-of-region strategy absent the proposed transaction.**

33. All available evidence confirms that SBC's National/Local strategy is a merger-specific efficiency because neither party would have pursued a significant out-of-region strategy in the absence of the proposed transaction. The fact that neither SBC, Ameritech nor any other RBOC has pursued a significant out-of-region strategy to date further supports the proposition that the merger enables the out-of-region strategy.

**D. ABSENT THE NATIONAL/LOCAL STRATEGY, SBC AND AMERITECH CANNOT BE CONSIDERED SIGNIFICANT POTENTIAL ENTRANTS INTO EACH OTHER'S HOME TERRITORY.**

34. At the same time that opponents explain how SBC and Ameritech easily could have pursued a significant out-of-region strategy by relying on resale or rebundling network elements, they argue that potential competition is significantly diminished by the proposed transaction. However, if SBC or Ameritech were to pursue a non-facilities based strategy, they would be only two of many firms with the ability to do so.<sup>23</sup>

35. Outside their home regions, SBC and Ameritech have relatively little brand recognition and thus offer little advantage over other CLECs as resellers of other firms' services and facilities. SBC, for example, offers out-of-region cellular services under the "Cellular One" brand name, not "SBC." In its recent approval of the SBC/SNET merger, the FCC emphasized the lack of significance of RBOCs' brand names for entering into the provision of out-of-region local services. In evaluating the likelihood that SBC would enter into the provision of local service into Connecticut, the FCC stated:

[E]ven if SBC has some brand name reputation through its Cellular One wireless operations in areas adjacent to SNET's territory, it appears no more strongly positioned to enter the local residential and small business market in Connecticut than is any

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<sup>23</sup> Potential competition issues are addressed in the affidavit submitted by R. Schmalensee and W. Taylor that accompanied SBC's and Ameritech's Application.

other wireless carrier that operates in Connecticut or adjacent areas.<sup>24</sup>

36. Neither SBC nor Ameritech should be regarded as one of only a few significant potential entrants using resale or rebundled elements since these firms have no advantage in doing so relative to many other firms. They are only two of many firms with the ability to enter on this basis.<sup>25</sup> The FCC concurred with this general view in concluding that SBC had no unique incentive or ability to provide local service in Connecticut (outside its National/Local plan):

There is no evidence in the record, and parties opposing the merger have offered no evidence, upon which we could conclude that SBC has any significant capabilities or incentives to compete in the relevant local business market in Connecticut that are not shared by many of these other entrants in local business markets throughout the country, including Connecticut. Accordingly, we conclude that the proposed merger between SBC and SNET is unlikely to adversely affect the development of competition in this market.<sup>26</sup>

37. More generally, absent the merger and National/Local strategy, SBC and Ameritech have no special advantage in providing CLEC services outside their home regions. The FCC's opinion in MCI WorldCom recognizes this fact:

Currently, firms are adopting a variety of strategies for entering this market and meeting with initial success, suggesting that no one combination of capabilities can be deemed essential to success.<sup>27</sup>

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<sup>24</sup> FCC SBC/SNET Order, ¶19.

<sup>25</sup> My prior affidavit (pp. 23-32) discusses several CLECs adopting a variety of entry strategies, including: Allegiance Telecom; AT&T/TCI/TCG; Covad; Cox Communications; e.spire; Electric Lightwave; Focal Telecommunications; GST Telecommunications; Hyperion; ICG Communications; Intermedia Communications; Level 3 Communications; McLeodUSA; MCI WorldCom; NextLink; Sprint; Time-Warner Telecom; Teligent; and WinStar.

<sup>26</sup> SBC/SNET Order, ¶20.

<sup>27</sup> FCC Opinion in MCI WorldCom, ¶180.

38. To note one recent example of CLEC entry, on October 27, 1998, Teligent announced deployment of local exchange services in 10 cities around the nation, offering discounts of 30 percent below ILEC rates for local service.<sup>28</sup>

**E. OPPONENTS DO NOT DISPUTE THAT SBC'S DEPLOYMENT OF THE NATIONAL/LOCAL PLAN WILL BE ACCELERATED BY THE MERGER, EVEN ASSUMING, CONTRARY TO THE EVIDENCE, THAT SUCH ENTRY WOULD OCCUR ABSENT THE MERGER.**

39. While the opponents claim that the merger is not needed to pursue the National/Local strategy, they do not even attempt to rebut my analysis indicating that the proposed transaction will accelerate deployment of an out-of-region strategy. My initial affidavit emphasized that, "even if SBC could have pursued an out-of-region strategy on its own, the Ameritech transaction speeds its deployment."<sup>29</sup>

40. Even if, as MCI WorldCom's affiants Baseman and Kelley (p. 35) suggest, "SBC and Ameritech are likely to enter local service out-of-region as and if local competition begins to become significant in their regions," any such entry would be in the future, not today. The merger would still benefit consumers by accelerating entry. Delays in deployment of new products and services can impose large costs on consumers.<sup>30</sup> The FCC also has emphasized that accelerating deployment of facilities and services is a merger-specific efficiency that can benefit consumers.<sup>31</sup>

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<sup>28</sup> The cities include: New York, Chicago, Dallas/Ft. Worth, Austin, Denver, Los Angeles, Houston, San Antonio, Washington, D.C., and Tampa. Teligent ran multiple page newspaper advertisements around the country announcing its multiregion deployment. Teligent also deployed a 60 foot billboard in New York's Times Square.  
<<http://www.teligentinc.com/whatsnew/whatsnew.html>>

<sup>29</sup> Carlton Affidavit, p. 15.

<sup>30</sup> See, for example, J. Hausman, "Valuing the Effect of Regulation on New Services in Telecommunications," Brookings Papers on Economic Activity: Microeconomics (1997), p. 1.

<sup>31</sup> The FCC's AT&T-Teleport Order (¶45) states: "... we find that a primary benefit of the merger is that it will increase the competitive choices available to consumers ... more quickly than would occur absent the merger." The FCC's MCI WorldCom Order (¶199) states, "... we conclude that ... the merged entity will be able to expand its operations and enter into local markets more quickly than either party could absent the merger."

41. As noted above, the analysis in my prior affidavit indicated that the proposed transaction accelerated SBC's deployment of an out-of-region strategy by: (i) increasing "on-net" coverage of large multilocation providers with headquarters in SBC's region; (ii) increasing the available supply of skilled managerial and technical personnel to deploy facilities in 30 out-of-region cities while maintaining high quality service to existing customers; and (iii) reducing the number of cities in which facilities must be deployed.

42. Opponents' comments mischaracterize my analysis and, in the process, fail to rebut the conclusions expressed in my prior affidavit.

- AT&T, for example, cites my prior affidavit to support its claim that "[a]pplicants concede that each could have entered 15 out-of-region markets in the same period without this merger."<sup>32</sup> This statement clearly mischaracterizes my testimony. My affidavit presented a calculation of the number of Fortune 500 companies for which SBC and Ameritech (separately) could provide "near-national" coverage *if* each were to deploy facilities in 15 out-of-region cities. My affidavit states "[f]or example, if Ameritech and SBC did not merge but each deployed facilities in 15 out-of-region MSAs, then ..."<sup>33</sup> AT&T's attempt to characterize this as a "concession" that each would deploy facilities in 15 cities is plainly wrong.<sup>34</sup>
- AT&T's claim that "nor is there any basis for concluding that entry into any given market will be faster with the merger than without it"<sup>35</sup> relies solely on the claim that "each party concededly (sic) can accomplish a 15 city build unilaterally; together they can do a 30 city build. But either way there are thirty sets of facilities built in the

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<sup>32</sup> AT&T Petition, p. 41.

<sup>33</sup> Carlton Affidavit, ¶29.

<sup>34</sup> I note that if SBC or Ameritech, hypothetically, were to deploy facilities in 15 out-of-region cities, each would offer services in only about 25 cities, far below the number in which AT&T and MCI WorldCom are deploying services.

<sup>35</sup> AT&T Petition, p. 42.

same time frame.”<sup>36</sup> As stated above, however, my affidavit contains nothing resembling such a “concession” and shows that neither company could separately achieve as effective a national footprint on its own as with the merger.

- My affidavit stated that “[i]t is unlikely that SBC would have as much success in marketing to ‘anchor tenants’ if it could only promise that a near national footprint would be available in ten years.”<sup>37</sup> AT&T, however, now claims that this statement “could only be designed to mislead” because “[a]pplicants’ submission setting forth their 30 city plan utilizes the same [10-year] time frame.”<sup>38</sup> Again, AT&T grossly misrepresents the facts. In contrast to AT&T’s claim, SBC initially planned to deploy facilities in each of the 30 cities within four years, not 10, and SBC had planned to deploy facilities covering nearly 70 percent of the targeted out-of-region business lines by 2001. SBC, however, has accelerated its planned deployment of facilities and now anticipates having facilities in most of these 30 markets within 18 months of the transaction’s closing.<sup>39</sup> SBC’s “10-year time horizon” reflects only the period used in its financial projections.
- AT&T’s attempt to rebut my claim that the merger permits more effective utilization of scarce managerial and technical resources also is erroneous.<sup>40</sup> Although the National/Local plan requires a significant number of new employees, AT&T is simply incorrect in suggesting that this all will be accomplished through new hires. Instead, the larger base of managerial and technical employees achieved through the merger permits more efficient utilization of existing managerial resources in deploying new facilities and service out-of-region and in providing service to current customers.

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<sup>36</sup>

Ibid.

<sup>37</sup>

Carlton Affidavit, ¶22.

<sup>38</sup>

AT&T Petition, p. 42.

<sup>39</sup>

Kahan Reply Affidavit.

<sup>40</sup>

AT&T Petition, p. 42-43.

- Finally, AT&T's suggestion that "the merger [cannot] result in any economy of scope since Ameritech and SBC are both engaged in the same lines of businesses..." reflects a basic misunderstanding of the term "economies of scope." As I explain in my textbook, a firm realizes economies of scope when "it is less costly for one firm to perform two activities than for two specialized firms to perform them separately."<sup>41</sup> Since Ameritech and SBC employees possess significant knowledge about different services, equipment and locations -- knowledge that can be used in deploying local services out-of-region and in improving service in each other's home regions -- the transaction is likely to create significant economies of scope. Therefore, AT&T's claim that "Ameritech's employees do not possess any skills that SBC's do not already have (and vice-versa),"<sup>42</sup> apart from having no factual basis, cannot be used to support its claim that the merger fails to result in economies of scope.

**F. BELL ATLANTIC/GTE'S PLANS PROVIDE FURTHER EVIDENCE THAT THE SBC/AMERITECH MERGER ENABLES THE DEPLOYMENT OF AN OUT-OF-REGION STRATEGY.**

43. The proposed merger of Bell Atlantic and GTE confirms the analysis presented in my earlier affidavit that the merger enables the deployment of significant out-of-region services.

44. Like SBC and Ameritech, neither Bell Atlantic nor GTE had undertaken broad-scale efforts to provide out-of-region local services prior to their announced transaction.<sup>43</sup> Bell Atlantic and GTE state that "[n]either company alone could hope to launch a serious and

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<sup>41</sup> Carlton and Perloff, Modern Industrial Organization, 2nd Edition (1994), p. 37.

<sup>42</sup> AT&T Petition, p. 43.

<sup>43</sup> In 1997 GTE announced limited out-of-region efforts, focussing on customers with complex communications needs located near GTE's local or wireless facilities. (Declaration of Jeffrey C. Kissel, Vice-President of National Marketing for GTE Business Development and Integration, in support of BA/GTE Merger, ¶13.)



sustained entry into this many markets in so short a time.”<sup>44</sup> They also state that “[t]he merged company’s greater scale also makes possible faster deployment of facilities ...”<sup>45</sup>

**G. CONCLUSION: SBC’S NATIONAL/LOCAL STRATEGY IS A MERGER-SPECIFIC EFFICIENCY.**

45. While opponents recognize the economic logic of SBC’s National/Local plan, they claim that it is not a merger-specific efficiency because, they assert, SBC and Ameritech each would have deployed such a strategy absent the transaction. All available evidence, however, points to the contrary: (i) Neither SBC, Ameritech nor any other RBOC had undertaken such a strategy in the past; (ii) neither SBC, Ameritech nor any other RBOC had any plans to do so absent the merger; (iii) and even if, contrary to fact, one nonetheless believes that SBC and Ameritech each would have pursued such a strategy absent the merger, opponents fail to rebut the claim that SBC’s National/Local plan speeds deployment relative to what otherwise would be expected. Bell Atlantic/GTE’s plan to deploy out-of-region services and facilities provides further evidence that the proposed transaction enables deployment of SBC’s National/Local strategy.

46. The unavoidable conclusion is that the National/Local strategy is a merger-specific efficiency that will benefit consumers significantly.

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<sup>44</sup> Kissel Declaration, ¶14.

<sup>45</sup> BA/GTE Public Interest Statement, p. 8. It should be noted that Bell Atlantic/GTE, unlike SBC, does not appear to anticipate offering local service to residential customers using its out-of-region facilities.

**III. OPPONENTS INCORRECTLY CLAIM THAT SBC HAS NOT MADE A SIGNIFICANT COMMITMENT TO THE NATIONAL/LOCAL STRATEGY.**

**A. SBC HAS MADE A CREDIBLE COMMITMENT TO DEPLOYING THE NATIONAL/LOCAL STRATEGY.**

47. AT&T, MCI WorldCom and Sprint each claim that SBC has not made a significant commitment to the National/Local strategy.<sup>46</sup> MCI WorldCom goes so far as to claim that the plan is a “ruse” and a “bluff.”<sup>47</sup>

48. Opponents, however, never identify the type of statements that SBC should make to provide assurance of their commitment to the National/Local strategy. As discussed in my earlier affidavit, SBC has stated its commitment to the National/Local plan to Congress, the SEC, investors, analysts, the FCC, the Department of Justice, state regulators and others.

49. SBC managers, in effect, post their reputations as a bond when making such repeated public commitments. Backing away from such statements would result in significant damage to the reputation of SBC's managers as well as the reputation of the corporation. Lack of credibility would be likely to cause significant harm to their future careers as well as to the investor community's valuation of SBC.

50. SBC's commitment to the National/Local plan is also reflected by the following:

- SBC has made significant investments in the plan that would not be recovered if the plan did not go forward. As discussed in the accompanying reply affidavit of James Kahan, SBC has announced the appointment of an officer in charge of implementation of the National/Local plan and has assigned several senior executives and related staff to the project.<sup>48</sup>

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<sup>46</sup> Sprint Petition, pp. 48-50; AT&T Petition, p. 35.

<sup>47</sup> MCI WorldCom Comments, p. iii, p. 9.

<sup>48</sup> Kahan Reply Affidavit.

- SBC's commitment to the National/Local plan is also reflected in its intention to begin deploying facilities immediately following the transaction's closing. The creation of these "sunk" costs would effectively penalize SBC if it were to back away from its commitment to the National/Local plan.
- SBC also has accelerated its planned deployment of the National/Local plan relative to the schedule initially anticipated. SBC now plans to deploy facilities in most of the 30 out-of-region markets within 18 months after the transaction closing and deploying fiber within two years. This is significantly faster than originally contemplated in the National/Local plan.<sup>49</sup>

**B. OPPONENTS' CLAIMS THAT SBC IS NOT COMMITTED TO THE NATIONAL/LOCAL PLAN ARE INCONSISTENT WITH THEIR CLAIM THAT SBC WOULD PURSUE THE PLAN IN THE ABSENCE OF THE MERGER.**

51. The merger's opponents speculate that SBC's National/Local strategy would not benefit consumers because SBC is not committed to undertaking the strategy. In contrast, as discussed in Section II above, opponents also speculate that the National/Local strategy would not benefit consumers because SBC and Ameritech each would have pursued such a strategy in the absence of the merger. Opponents cannot have it both ways. The FCC must evaluate the credibility of SBC's commitment to its out-of-region entry plan as well as the credibility of opponents' inconsistent claims and criticisms.

52. The FCC would set a dangerous precedent in accepting without supporting evidence the business judgment of SBC's competitors that, absent the proposed merger, SBC and Ameritech would each undertake an out-of-region strategy as rapid and as broad in scope as that currently envisioned with the merger. SBC and Ameritech have never before stated any

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<sup>49</sup> Ibid.

intention to engage in such a strategy and opponents have presented no evidence that they would be expected to do so absent the merger.

**IV. THE PROPOSED TRANSACTION WILL CREATE A SIGNIFICANT COMPETITIVE CHALLENGE TO OPPONENTS, A FACT THAT THE FCC MUST CONSIDER IN INTERPRETING THEIR CLAIMS.**

53. AT&T, MCI WorldCom and Sprint each oppose the transaction and deny that the proposed transaction will generate benefits to consumers. These firms, however, are the only ones now attempting to provide telecommunications services on an end-to-end basis throughout the United States and have already achieved, or are now attempting to achieve, the scale and scope that SBC hopes to attain.<sup>50</sup> Under these circumstances, the opponents' desire to stop the proposed transaction are understandable, but is based on a desire to limit competition.

**A. THE TRANSACTION CREATES A SIGNIFICANT NEW END-TO-END SUPPLIER THAT WILL COMPETE WITH THE OPPONENTS.**

54. Competitors should be expected to oppose a transaction that creates a significant new competitor. The proposed merger of SBC and Ameritech creates a significant new rival to AT&T, MCI WorldCom and Sprint that promises to offer packages of telecommunications services on an end-to-end basis to multilocation customers and others nationally.

55. The potential competitive significance of SBC/Ameritech is widely recognized by analysts. For example, analysts Dresdner, Kleinwort, and Benson recently stated that:

Mergers, alliances and RBOC progress towards long distance [entry] means that every large carrier will provide a broad range of services. We call this convergence . . . SBC and Bell Atlantic's mergers are the first step towards creating two new huge local and long distance carriers that should rival the Big-3 -- AT&T, MCI-Worldcom and Sprint after the turn of the century.<sup>51</sup>

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<sup>50</sup> See Kahan Reply Affidavit for an evaluation of the scope of AT&T's and MCI WorldCom's activities.

<sup>51</sup> Dresdner, Kleinwort Benson Research, "AT&T, Sprint and MCI WorldCom," August 20, 1998,

56. SBC/Ameritech will compete with IXC's and CLEC's in serving business and residential customers while, at the same time, purchasing services from CLEC's and out-of-region ILEC's (through the smart build strategy). In evaluating the objections to the proposed merger raised by IXC's and CLEC's, it is important to remember that the out-of-region strategy, if successful, will subject these firms to potentially large increases in competition.

**B. THE CREATION OF A NEW NATIONAL COMPETITOR CAN HAVE A SIGNIFICANT PROCOMPETITIVE IMPACT.**

57. Opponents suggest that there is already "adequate" competition for large customers and that as a result the "SBC-Ameritech transaction produces few, if any, benefits."<sup>52</sup> Opponents, however, provide no basis for this claim. As discussed above, only a handful of firms are even today beginning to offer packages of services at multiple locations.

58. A new participant can have a strong procompetitive impact in an emerging sector, such as this one, in which there are only three firms attempting to offer packages of services on a nationwide basis. The creation of a fourth firm competing to gain "first mover" advantages can result in significant consumer benefits.<sup>53</sup>

59. In these circumstances, the benefits from competition resulting from the creation of a significant new competitor as a result of this merger must carry great weight relative to unfounded claims that the transaction reduces competition by eliminating one of many potential competitors.

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p. 9).

<sup>52</sup> Baseman and Kelley, p. 34.

<sup>53</sup> My initial affidavit (¶11) reported that a one percent decline in local service rates among target consumers in the 30 cities where SBC intends to deploy facilities and services would result in an annual savings of roughly \$175 million. Of this total, residential customers would achieve savings in local service costs of roughly \$61 million and small business customers would save roughly \$57 million.

**C. IN CONTRAST TO COMPLAINTS MADE BY SBC'S POTENTIAL RIVALS, THE TRANSACTION IS SUPPORTED BY MANY LARGE BUSINESS CUSTOMERS.**

60. Opponents claim that the proposed transaction will not benefit large business customers and further argue that the proposed transaction will actually harm competition. These claims, however, are directly contradicted by a variety of large business customers who strongly support the proposed transaction. These customers stress that the merger will create a significant national supplier of telecommunication services. Portions of customer letters are briefly quoted below:

- Compaq Computer: "Our desire is to have as many 'full capacity' vendors as possible in the marketplace. SBC's entry into the national marketplace is important and would provide a viable national vendor."
- Travelers Group: "Few businesses are as completely dependent on reliable and cost-effective communications services as those in the financial services industry. ... The approval of the proposed merger will allow [SBC, Ameritech, SNET] to expand their services and make the merged company a significant competitor that we can consider in the national and global market."
- Emerson Electric: "We must have a reliable, cost-effective telecommunications services from a minimum number of providers. In the case of Emerson, a merger of SBC and Ameritech would create a provider with the geographic range and depth to be considered as a preferred supplier. Without the merger they are to us both 'niche' players, with neither one being of high impact to Emerson."
- Shell Oil: "Shell did not even consider SBC in its most recent solicitation of bids to provide Shell's long distance voice and data services because of SBC's inability to provide service in certain areas of the United States. ... The merger with Ameritech combined with the National-Local Strategy, which SBC has announced, will make

SBC the kind of national and global carrier that Shell looks to when purchasing telecommunications services."

61. Additional supporting letters have been received from, among others, Ultramar/Diamond Shamrock (cited in Section II.A above), Amoco, Cendant, Edward Jones Company, and Levi Strauss. These letters provide real-world evidence of the benefits of the merger as perceived by major customers.

**D. OPPONENTS CONFUSE HARM TO COMPETITORS AND HARM TO COMPETITION.**

62. While opponents claim that the proposed transaction will harm competition, a review of their comments suggest that they confuse harm to competition and harm to themselves resulting from increased competition.

63. MCI WorldCom, for example, acknowledges that SBC/Ameritech will be an efficient and formidable nationwide competitor capable of offering packages of services to multilocation customers. For example, MCI WorldCom states:

The higher the percentage of locations of a multi-location customer to which a LEC is able to provide local services exclusively over its own facilities, the greater its competitive advantage.<sup>54</sup>

SBC-Ameritech's advantage would be especially great in marketing to customers with all or most of their locations in the SBC-Ameritech region, and that category is likely to include companies headquartered in the SBC-Ameritech region, where decisions concerning the telecommunications needs of a particular company are typically made.<sup>55</sup>

Because a smaller portion of the country will be out-of-region after the proposed merger, the amount of investment needed to achieve control over the facilities used to serve any given percentage of locations is smaller for the merged firm than for each firm alone.<sup>56</sup>

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<sup>54</sup> MCI WorldCom Comments, p. 11.

<sup>55</sup> *Ibid.*

<sup>56</sup> *Ibid.*, pp. 11-12.

Of course, the amount of investment that SBC-Ameritech would need to serve all or most of the out-of-region locations of large businesses headquartered in its region will be substantially less than the investment required by CLECs to provide facilities-based local service to these customers at all of their in-region and out-of-region locations.<sup>57</sup>

64. While MCI WorldCom complains that these factors give SBC/Ameritech an “artificial advantage,”<sup>58</sup> MCI WorldCom’s comments are remarkably similar to the procompetitive rationale for the transaction discussed in SBC’s application and my prior affidavit. MCI WorldCom’s comments reflect the recognition that the merger enables SBC efficiently to provide near national service to many multilocation customers, especially those with headquarters in SBC’s home territory. A competitive advantage that benefits customers is procompetitive, even if MCI WorldCom loses business. MCI WorldCom’s comments demonstrates a basic confusion of a harm to competition and harm to MCI WorldCom.

65. In evaluating this transaction as well as others now being undertaken in the telecommunications industry, it is important to remember that the existing structure of all firms in the industry has been an artifact of regulation, not economic efficiency. MCI WorldCom’s comments highlight the fact that the current structure of the telecommunications sector is based on a non-economic legacy of regulatory decrees. In such circumstances, mergers, such as that proposed by SBC and Ameritech, are likely to enable firms to realize significant efficiency gains. Indeed, as I’ve already stated, mergers have allowed AT&T and MCI WorldCom to expand their scale and scope.

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<sup>57</sup> Ibid., p. 12.

<sup>58</sup> Ibid., p. 13.



**V. IN CONTRAST TO OPPONENTS' CLAIMS, THE PROPOSED TRANSACTION WILL NOT RESULT IN COLLUSION AND INSTEAD IS LIKELY TO BENEFIT CONSUMERS BY TRIGGERING PROCOMPETITIVE RESPONSES BY OTHER FIRMS.**

**A. THERE IS NO BASIS FOR OPPONENTS' CLAIM THAT THE PROPOSED TRANSACTION WILL LEAD TO COLLUSION AMONG RBOCS.**

66. Certain merger opponents also claim that, as a result of the proposed merger, the remaining RBOCs are likely to "arrive at a tacit mutual non-aggression pact."<sup>59</sup> There is no basis to this claim. To the contrary, economic theory and available evidence indicates that the proposed transaction is likely to generate procompetitive responses from other RBOCs.

67. Opponents attempt to support their view that the proposed transaction will lead to collusion by incorrectly citing a paper of mine that used what the paper called a "highly stylized" example to show when competition would not be expected.<sup>60</sup> That example involves two gas stations in a small town that are located directly across the street from one another, which sell identical products, observe immediately each other's price, face no impediments to changing price, and face no other competition as well as no possibility of entry. In such a case, one might expect to see only limited competition between the two firms.

68. The opponents' attempts to use this simple example as a basis to claim that RBOCs would not compete with each other is completely without foundation. Although opponents cite the gas station example in my paper, they ignore the discussion in the same paper (and in my textbook) of a variety of factors that make collusion unlikely, including the possibility of negotiated prices, imperfect information among buyers and sellers, long-term

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<sup>59</sup> Comments of Level 3 Telecommunications, Inc., p. 4. A similar point is made in comments prepared by the law firm Swidler & Berlin Shereef and Freedman LLP, including those submitted on behalf of Hyperion (pp. 5-8); and McLeod USA (pp. 3-5).

<sup>60</sup> D. Carlton, R. Gertner and A. Rosenfield, "Communication Among Competitors: Game Theory and Antitrust," 5 George Mason Law Review 423 (1997).

commitments on the part of buyers and sellers, heterogeneous products and rapidly changing industry conditions.<sup>61</sup>

69. The provision of telecommunications services, especially to business customers, is characterized by many factors that would greatly complicate attempts by telecommunications firms to collude. These include: (i) the sophisticated and differentiated nature of the products and services at issue; (ii) complex pricing; (iii) differences in quality across suppliers; and (iv) rapidly changing industry conditions. Each of these circumstances complicates collusion, relative to the simple gas station example cited by opponents, by greatly increasing the complexity of monitoring a collusive arrangement. The likelihood of success of a collusive agreement in the telecommunications industry is further reduced by the ability of suppliers to enter into long-term contracts with customers, which increases the incentive to cheat on any such collusive agreement.

70. Perhaps most important, however, the gas station example explicitly involves a circumstance in which only two firms compete. In providing telecommunications services, however, there are already three existing firms (AT&T, MCI WorldCom, and Sprint) that have achieved, or are attempting to achieve, the scale and scope to provide packages of end-to-end services nationally. Even if some RBOCs did pursue a National/Local strategy, collusion among RBOCs would fail unless these other significant competitors also participated. There is no basis for suggesting that the proposed merger will result in collusion involving all national carriers.

71. Moreover, SBC's plans to deploy its National/Local strategy also directly contradict opponents' claims that the merger will lead to collusion among RBOCs. Instead, SBC's actions indicate that it intends to challenge other RBOCs as well as AT&T, MCI WorldCom and Sprint. These actions are completely at odds with opponents' suggestions that the merger will result in collusive agreements among these firms.

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<sup>61</sup> See Carlton, Gertner and Rosenfield, pp. 432-3. Also see Carlton and Perloff, Modern Industrial Organization, 2nd edition (1994), Chapter 6 for a more complete discussion of

**B. SBC'S STRATEGY IS LIKELY TO GENERATE PROCOMPETITIVE RESPONSES FROM OTHER FIRMS.**

72. In contrast to opponents' suggestion that the proposed transaction will result in collusion, economic theory and available evidence indicate that consumers are likely to enjoy further benefits because the merger is likely to generate procompetitive responses from other firms in the industry.

73. The economic literature recognizes that investments by one firm are likely to generate procompetitive responses from others. First, actions by one firm often have a "demonstration effect" that results because one firm's behavior reveals information that reduces risks associated with adopting new technologies and strategies.

As more information and experience accumulate, it becomes less risky to begin using it. Competitive pressures mount and 'bandwagon' effects occur.<sup>62</sup> [...] The probability that a firm will introduce a new technique is an increasing function of the proportion of firms already using it ...<sup>63</sup>

74. Second, firms may emulate the activities of others even before the success of an investment or strategy can be determined, especially if the management of innovating firms has past records of success.

The thrust of the argument is that the actions of others conveys information that is valuable in one's own private decision making.<sup>64</sup>

75. Past experience indicates that RBOCs have often made similar investments and followed similar strategies, suggesting that others may seek ways to imitate the National/Local

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factors affecting the ability of firms to collude.

<sup>62</sup> E. Mansfield, "Technical Change and the Rate of Imitation," 29 *Econometrica* 741 (1961), pp. 745-6.

<sup>63</sup> *Ibid.*, pp. 762-3.

<sup>64</sup> T. T. Palley, "Safety in Numbers: A Model of Managerial Herd Behavior," 28 *J. of Economic Behavior and Org.* 443 (1995), commenting on: D.S. Sharfstein and Jeremy C. Stein, "Herd Behavior and Investment," 80 *American Economic Review* 465 (1990); and A. V. Banerjee, "A Simple Model of Herd Behavior," 107 *Q. Journal of Economics* 797 (1992).

strategy. For example, my review of SEC filings and annual reports prepared by the RBOCs and GTE since the mid-1980s indicates that:

- 8 invested in foreign cellular ventures;
- 8 invested in providing out-of-region cellular service in the U.S.;
- 7 invested in local service ventures outside the U.S.;
- 7 invested in paging services in the U.S.;
- 6 invested in foreign directory publishing activities.

**C. THE PROPOSED MERGER OF BELL ATLANTIC AND GTE SHOWS THAT SBC'S STRATEGY HAS ALREADY TRIGGERED RESPONSES BY OTHER LARGE ILECS.**

76. Opponents have expressed skepticism regarding whether SBC's National/Local strategy is likely to generate similar responses by other RBOCs, including whether others will enter into SBC's and Ameritech's home territories.<sup>65</sup> The marketplace has already provided an unambiguous answer to this question.

77. As already discussed, Bell Atlantic and GTE have recently announced their intention to offer packages of services (including local, Internet, data, long distance, wireless, and international services) in 21 out-of-region areas, including 12 areas in SBC/Ameritech's home territory: Austin, Chicago, Cleveland, Cincinnati, Dallas, Detroit, Houston, Indianapolis, Los Angeles, San Antonio, San Diego, and San Francisco.

78. Bell Atlantic and GTE have clearly described their actions as a response to SBC/Ameritech's plan and commitment to offering packages of services on a nationwide basis. GTE's Chairman and CEO recently stated:

The business is evolving quickly to a nationwide market for bundled services, and other local exchange companies such as SBC have made it clear that they intend to compete in Bell Atlantic's region. This merger will allow Bell Atlantic and GTE to

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<sup>65</sup> See, for example, MCI Worldcom Comments, p. iii, and Baseman and Kelley, p. 36.

respond in kind. It will allow the combined company to compete on a national scale, and it will provide a base from which to launch a competitive strike against the other Bell companies.<sup>66</sup>

79. It is impossible, of course, to determine with any precision today whether, how, and when other RBOCs and ILECs will respond to SBC/Ameritech's strategy. Other firms' responses may take a variety of forms and need not mimic SBC/Ameritech's or Bell Atlantic/GTE's out-of-region plans. For example, SBC acquired and operates out-of-region cellular facilities on its own, Bell South participates in a joint venture with AT&T, and Bell Atlantic participates in a PCS joint venture with AirTouch. US West, like Pacific Telesis, divested both its in-region and out-of-region cellular properties (while continuing to invest in PCS properties). The diversity of RBOCs' out-of-region cellular strategies provides evidence of the diversity of firms' responses in pursuing the similar overall goals.

**VI. OPPONENTS CORRECTLY NOTE THAT THE NATIONAL/LOCAL PLAN REQUIRES LONG DISTANCE AUTHORITY, BUT FAIL TO RECOGNIZE THAT THIS WILL BENEFIT CONSUMERS BY ACCELERATING ENTRY INTO THE PROVISION OF IN-REGION LONG DISTANCE SERVICES.**

**A. ACCELERATION OF SBC ENTRY INTO IN-REGION LONG DISTANCE WILL HAVE SIGNIFICANT CONSUMER BENEFITS.**

80. Opponents correctly note that the National/Local plan requires that SBC obtain authority to provide in-region long distance. These circumstances increase the already great incentives for SBC to meet the FCC's requirements for providing in-region long distance service. The acceleration of SBC/Ameritech's authority to provide in-region interLATA services will benefit consumers in a variety of ways including: (i) enabling SBC to offer packages of local, long distance and data services desired by consumers; and (ii) providing CLECs in SBC's and

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<sup>66</sup> Prepared Testimony of Charles R. Lee, Chairman and CEO of GTE before the Senate Committee on the Judiciary Subcommittee on Antitrust, Business Rights and Competition, September 15, 1998.

Ameritech's regions further assurances of non-discriminatory local access, the ability to purchase network elements and the ability to resell services.

81. In-region customers, including residential and small business customers, are likely to benefit greatly from SBC's deployment of bundled local/long distance service. The success of ILECs who have entered into the provision of long distance service provides strong evidence that many residential and small business consumers prefer to deal with one supplier for both their local and long distance telephone services. For example:

- Between 1994 and 1996, SNET gained 783,000 long distance subscribers, about 37 percent of the lines it serves.<sup>67</sup>
- Between 1996 and April 1998, GTE gained more than 2 million long distance customers, about 10 percent of the subscriber lines it serves.<sup>68</sup>
- Additionally, the FCC reported in its Opinion in the SBC/PacTel merger that "according to one recent research report, nearly 80% of American households would like to receive telecommunications services...from a single provider, if the overall cost remained the same."<sup>69</sup>

**B. IN-REGION INTERLATA AUTHORITY IS ALSO LIKELY TO ACCELERATE COMPETITION IN THE PROVISION OF LOCAL SERVICES.**

82. As discussed above, the development of new products and services is likely to lead to procompetitive responses by rival firms. Available evidence indicates that SBC's entry into the provision of in-region interLATA services will accelerate competition in the provision of local service. For example, SNET's entry into the provision of in-region interLATA services accelerated local competition from AT&T, which made Connecticut the first area where it offered

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<sup>67</sup> FCC, Long Distance Market Shares, 2nd Quarter, 1998, Table 2.1, and FCC, Distribution of Equal Access lines and Presubscribed lines, November 1997, Table 5.

<sup>68</sup> GTE, April 2, 1998 advertisement in Wall St. Journal; Bell Atlantic/GTE Merger Fact sheet. <<http://www.gte.com/g/ghgtebel.html>>

<sup>69</sup> SBC/Pacific Telesis Memorandum, Opinion and Order, CC Docket 97-28, ¶48.

local service to residential and business customers statewide.<sup>70</sup> AT&T presumably was responding to the demand for "one-stop shopping" for local and long distance service by Connecticut consumers. In addition, AT&T responded to SNET's entry into in-region long distance by lowering prices for presubscribed intraLATA toll customers.<sup>71</sup>

**C. THE NATIONAL/LOCAL PLAN ALSO WILL ACCELERATE THE PROVISION OF IN-REGION LONG DISTANCE BY OTHER RBOCS.**

83. SBC's deployment of facilities outside SBC's home states will provide facilities-based competition for large business, small business and residential customers.<sup>72</sup> This in turn will help other RBOCs win authority to provide in-region long distance services since the presence of facilities-based competition is one of the checklist conditions under Section 271. Therefore, the benefits of in-region provision of long distance service described above will accrue to consumers in regions other than SBC's and Ameritech's.

84. Finally, it should be noted that AT&T incorrectly suggests that SBC would be a de minimis competitive presence in serving residential and small business customers because it now anticipates achieving only a four percent share of such customers out-of-region. This figure is misleading because SBC does not anticipate deploying facilities and services capable of reaching all residential and small business customers and plans to target its services to those who desire bundled local and long distance service. In total, SBC is targeting about 25 percent of the total residential and small business customers in out-of-region areas and expects to service 16.5 percent of this target group after 10 years.

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<sup>70</sup> New Haven Register, March 1, 1997.

<sup>71</sup> For example, the Hartford Courant, May 7, 1994 stated: "The nation's largest long distance telephone company Friday got serious about competing for Connecticut's in-state long distance business. In a filing with the state utility regulators, AT&T Corp. said it will offer new promotional in-state long distance rates that are 10 percent below the regular rates charged by SNET."

<sup>72</sup> The deployment of service to small business and residential customers outside its region is an important part of the success of the National/Local plan. For example, small business and residential services contribute 33 percent of the revenue the National/Local plan is

**VII. OPPONENTS INCORRECTLY ARGUE THAT SBC'S SYNERGY ESTIMATES CAN BE REALIZED IN THE ABSENCE OF THE PROPOSED MERGER, OR, ALTERNATIVELY, ARE OVERSTATED.**

85. SBC's application describes a number of merger-specific efficiencies in addition to the National/Local plan, including cost savings that will result from sharing best practices and revenue enhancement resulting from the more rapid deployment of new products and services. In total, SBC claims that the merger creates opportunities for cost savings and revenue growth that by 2003 that will total roughly \$2.5 billion annually.<sup>73</sup>

86. The fact that mergers can result in significant efficiency gains is not controversial. For example, the Merger Guidelines of the Department of Justice and Federal Trade Commission recognize that:

Mergers have the potential to generate significant efficiencies by permitting a better utilization of existing assets, enabling the combined firm to achieve lower costs ... Indeed, the primary benefit of mergers to the economy is their potential to generate such efficiencies.<sup>74</sup>

87. Opponents, however, suggest alternatively that: (i) efficiencies claimed by SBC could be achieved in the absence of the proposed merger; and (ii) SBC's estimate of efficiencies are overstated. This section shows that opponents' claims that efficiencies can be realized without the merger are unrealistic and that, in contrast to opponents' suggestions, SBC has a credible record in making efficiency estimates.

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expected to generate by its fifth year of the plan and contributes roughly 22 percent of the estimated value of the plan.

<sup>73</sup> Kaplan Affidavit, p. 1.

<sup>74</sup> DOJ/FTC Merger Guidelines, Revised Section 4.



**A. OPPONENTS' SUGGESTIONS THAT BEST PRACTICES CAN BE SHARED  
ABSENT THE MERGER ARE UNREALISTIC.**

**1. Attempts to share best practices absent a merger are likely to be difficult due to high transaction costs.**

88. Opponents erroneously claim that the proposed merger is not necessary for SBC and Ameritech to achieve the claimed increases in efficiency. For example, Sprint argues that "the contention that Ameritech and SBC had no intention of competing with one another suggests that the diffusion of best practices would occur without a merger (i.e., contractually)."<sup>75</sup> Similarly, AT&T claims that "such cost cutting can be undertaken independent of the merger."<sup>76</sup>

89. These comments reflect an overly simplistic view of the mechanics of sharing information regarding best practices and new service deployment. In practice, even firms that do not compete typically do not share detailed information on their cost structure and methods of doing business. This is a consequence of the difficulty of determining the value of information that is exchanged and problems in structuring transactions under such circumstances.

90. Transactions between firms to exchange information regarding potential synergies can be very difficult to establish. Such information transfers often are more efficiently accomplished within a firm than through market transactions between firms. It has long been recognized that transaction costs such as these play a key role in determining the size and scope of a firm's activities. The greater the cost of market transactions, the greater the scope of activity that will be undertaken within a firm (where production is directed by managers), instead of through market transactions. This proposition was perhaps first recognized in a 1937 paper by Ronald Coase, cited by the Nobel Prize Committee in 1991, which noted that the scope of a firm's activity is determined by such transaction cost considerations:

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<sup>75</sup> Sprint Petition, p. 65.

<sup>76</sup> AT&T Petition, p. 47.

Outside the firm, price movements direct production, which is coordinated through a series of exchange transactions on the market. Within a firm, these market transactions are eliminated and in place of the complicated market structure with exchange transaction is substituted the entrepreneur-coordinator, who directs production.<sup>77</sup>

91. Attempts by SBC and Ameritech to achieve cost savings typically would involve detailed analysis and require significant involvement of many levels of management. It is unrealistic to claim that firms could readily transact to share such information, especially when each does not know the value of the cost-savings information that the other may impart. In this context, there is no basis for opponents' suggestion that best practices can be readily shared absent the proposed merger. I also note that such sharing has not been occurring.

**2. SBC's (on-going) process of sharing best practices from its merger with PacTel reveals the complexities involved in sharing best practices.**

92. SBC's current experience in realizing efficiencies in its acquisition of PacTel demonstrates the complexities of sharing best practices. In order to realize these synergies, SBC and PacTel established nearly 60 separate teams to identify cost savings and/or revenue enhancement opportunities. Examples include teams dealing with telemarketing, advertising, long distance, vertical services, real estate, bill printing, procurement, collections and many others. Each of these teams in turn identified a variety of cost savings and/or revenue enhancement initiatives. In total, SBC identified approximately 350 such initiatives which, in turn, reflect aggregates of even more detailed items.<sup>78</sup> To take only a few examples:<sup>79</sup>

- The "real estate" team identified cost savings initiatives relating to, among other things, utility costs, facilities management, contracting and purchasing, planning, leasing, and systems support.

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<sup>77</sup> R. H. Coase, "The Nature of the Firm," 4 *Economica* 386 (1937).

<sup>78</sup> Kaplan Reply Affidavit.

<sup>79</sup> These examples are taken from SBC's "Monthly SBC-PTG Merger Update Tracking Reports," August 1998.

- The “collections” team identified cost savings initiatives relating to, among other things, reengineering, credit bureau fees, account processing, and on-line payment.
- The “fleet operations” team identified cost savings initiatives relating to, among other things, consolidation of fuel and parts agreements, expanding Pacific’s warrantee program to SBC, and consolidating call centers.

93. Thus, opponents’ suggestion that any benefits could be realized in the absence of the proposed transaction fails to recognize the complexity of achieving cost savings. Indeed, if marketplace transactions to transfer such information could be so easily structured, then we would see far fewer mergers.

**B. SBC’S PAST HISTORY PROVIDES EVIDENCE THAT IT PROVIDES REALISTIC ESTIMATES OF SYNERGIES.**

94. Opponents also claim that SBC has not adequately documented its claimed efficiencies. AT&T, for example, claims that SBC has “fail[ed] to provide any support for their claimed savings other than the bare assertions of their affiant, Martin Kaplan.”<sup>80</sup> Sprint claims that “[t]he other claimed efficiencies are at best unsupported and, in practice, unlikely to be realized.”<sup>81</sup>

95. Needless to say, it is difficult if not impossible to document savings that are yet to be realized and, in many cases, yet to be identified. While the establishment of synergy estimates require significant elements of judgment, this does not necessarily imply that estimates are unreasonable or overstated. In this case, the credibility of SBC’s estimates of synergies that can be generated from the Ameritech transaction can be gauged by analyzing SBC’s track record in achieving the synergies claimed in its merger with PacTel. SBC’s

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<sup>80</sup> AT&T Petition, p. 47.

<sup>81</sup> Sprint Petition, p. 63.

experience from the PacTel transaction provides strong evidence that they provide realistic estimates of savings.

96. SBC maintains an on-going process of monitoring its progress in obtaining synergies from its acquisition of Pacific Telesis. These efforts, which include monthly progress reports, indicate that SBC is ahead of its goals in meeting the synergies it had projected.<sup>82</sup>

97. More specific examples of cost savings and revenue synergies being realized (both in PacTel's and SBC's territories) include:<sup>83</sup>

- Procurement: The merger enabled SBC/PacTel to renegotiate several hundred agreements with equipment vendors. Through September 1998, the procurement merger teams realized estimated savings of \$180 million, which exceeds their projection of savings that would be realized by that date.
- Operator services: The operator services team had realized \$40 million in cost savings and revenue enhancements as of September 1998. These savings result from, among other things, adoption of SBC's practices for automating collect and third-party calls, adoption of PacTel's practices for automating directory assistance calls, and elimination of various types of duplication.
- Computers/data processing: The computers/data processing team had realized \$40 million in savings by September 1998, which exceeds their projection of savings that would be realized by that date. These savings result from, among other things, standardization in desktop computing and reductions in maintenance costs.
- Directory publishing: The directory publishing team had realized synergies of \$80 million by September 1998. These synergies result from, among other things, improved "back room" operations and improved design of the directories.

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<sup>82</sup> SBC Merger Update - September 1998.

<sup>83</sup> The synergy estimates reported below are from the SBC Merger Update - September 1998 and reflect cumulative expense savings and revenue generation through September 1998 resulting from the merger.

98. Similarly, SBC's success in raising penetration of vertical services in PacTel's territory suggests that its estimate of revenue increases likely to result from the Ameritech transaction are credible. The PacTel experience provides a basis for estimates of increases in penetration likely to result from the SBC/Ameritech transaction.<sup>84</sup> SBC's success in increasing the penetration of vertical services in PacTel's territory is reflected in data indicating that:

- Between the second quarter of 1997 and the third quarter of 1998, the penetration rate for Caller ID in PacTel's territory increased from 2.6 percent to 11.5 percent (about nine percentage points). Over the same period, the penetration rate in SBC's territory increased from 43.0 percent to 49.2 percent (about six percentage points).<sup>85</sup>
- Over the same period, the average number of features per line in PacTel's territory increased from .73 to 1.03 (a 41 percent increase). By comparison, the average number of features per line in SBC's territory grew from 2.25 to 2.48 (a 10 percent increase).<sup>86</sup>

99. Available data also indicate that the penetration of vertical services that consumers value in Ameritech's territory is substantially lower than in SBC's. This indicates that the opportunities for increased penetration in Ameritech's territory are roughly similar to those SBC is facing in PacTel's territory.<sup>87</sup> For example:

- The penetration rate for Caller ID in Southwestern Bell's territory in the second quarter of 1998 was 49 percent compared to 30 percent for Ameritech.
- The penetration rate for call forwarding was 18.8 percent in Southwestern Bell's territory compared to 8.9 percent in Ameritech's region.

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<sup>84</sup> The Connecticut DPUC in its recent approval of SBC's acquisition of SNET recognized that SBC is "an international leader in the development and marketing of new telecommunications services . . ." (p. 42)

<sup>85</sup> Data provided by SBC Investor Relations.

<sup>86</sup> Ibid.

<sup>87</sup> The data reported below and in the following paragraph was provided by SBC and Ameritech.

- The penetration rate for auto callback service was 22.3 percent in Southwestern Bell's territory compared to 10.8 percent for Ameritech.
- In total, the average number of features per line in Ameritech's territory was 2.48 in Southwestern Bell's territory and 1.15 in Ameritech's territory.

100. In the same way, the merger is likely to enable SBC to achieve increases in penetration of Centrex services. In Ameritech's territory, roughly 41 percent of business lines are served by Centrex compared to 25 percent of business lines in SBC's territory. I understand that Ameritech has had success in marketing Centrex services to smaller business customers. Ameritech's experience may facilitate expansion of Centrex in SBC's territory.

101. In sum, SBC's success in meeting and exceeding its projected synergy goals from the PacTel transaction provides strong evidence that its estimated synergies from the proposed transaction are realistic.

**C. OPPONENTS' CLAIMS THAT THE TRANSACTION WILL REDUCE  
OUTSOURCING TO THIRD PARTIES IS AN ATTACK ON MERGER-SPECIFIC  
EFFICIENCIES THAT BENEFIT COMPETITION.**

102. Sprint claims that SBC's efficiency estimates overstate gains to society as a whole because the proposed transaction may raise costs for certain firms that are suppliers to Ameritech or SBC. Sprint claims that "consolidation may actually reduce net public benefits by raising outsourcing costs for independent firms ..."<sup>88</sup> Sprint argues that such circumstances could arise if the merged firm were to perform in-house certain function that had previously been outsourced to third parties. These third parties, they claim, may then not operate as efficiently with the possible consequence that third parties' other customers could face higher prices.

103. SBC's post-merger decisions regarding whether to outsource various functions or to perform them internally presumably will be based on efficiency considerations. Even if a

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<sup>88</sup> Sprint Petition, p. 67.

decision to reduce outsourcing certain functions has the effect of reducing the profitability of outside suppliers, this action would not result in harm to competition. Instead, such events would simply reflect the consequences of the competitive process, with inefficient firms shrinking and efficient firms expanding. In other words SBC's private interest in minimizing its costs does not conflict with society's interest. The protection of inefficient firms by preventing an efficiency-enhancing merger would harm consumers.

104. AT&T suggests, more generally, that the merger should not be approved because, in the absence of the merger, "true competition ... will force Applicants to become efficient or lose market share."<sup>89</sup> But this "true" competition somehow does not allow an efficiency-enhancing merger. Efficiency-enhancing mergers can promote competition by lowering firms' production costs and, ultimately, prices. AT&T's comments, in effect, reflect a call for antitrust policy to be used to protect inefficient firms from competition.

105. Ironically, the argument that mergers should not be approved in order to force existing firms "to become more efficient or lose market share" now propounded by AT&T also would have required denial of AT&T's merger with TCG as well as WorldCom's merger with MCI. Instead, the FCC correctly recognized in those cases that mergers can benefit consumers by enabling the merged firms to realize efficiencies and deliver better products and services to consumers.<sup>90</sup>

**VIII. OPPONENTS HAVE NO BASIS TO CONCLUDE THAT THE PROPOSED MERGER WILL REDUCE R&D AND SLOW THE DEVELOPMENT AND DEPLOYMENT OF NEW PRODUCTS AND TECHNOLOGIES.**

106. Opponents suggest that the proposed merger will not, as SBC claims, lead to synergies in research and development and in development and deployment of new products

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<sup>89</sup> AT&T Petition, p. 48.

<sup>90</sup> See the FCC's AT&T-Teleport Order (¶45) and MCI-WorldCom Order (¶199), quoted in footnote 31 above.

and services. Sprint, for example, states that “[t]he merger could thus actually reduce innovation incentives; in any event, neither economic theory nor empirical evidence supports Application’s (sic) claim that the merger would increase them.”<sup>91</sup>

107. While I agree with opponents that a merger’s impact on innovation cannot be determined on theoretical grounds,<sup>92</sup> available empirical evidence in this case indicates that the proposed merger will lead to the more rapid deployment of products and services.

**A. THE TRANSACTION CREATES SYNERGIES IN THE PROVISION OF R&D.**

108. Much of the rapid growth of the telecommunications industry in recent years has resulted from the introduction of new products and services, such as new data services and value added services. Technology Resources Inc. (TRI), SBC’s research and development subsidiary, has played a role in the development and deployment of a variety of new products and services introduced by SBC over the years. The value of this resource to consumers was recently recognized in the Connecticut Department of Public Utility Control’s (Connecticut DPUC) approval of SBC’s acquisition of SNET, which concluded that:

TRI will offer SNET and its customers earlier access to superior products and services and an enhanced telecommunications network.<sup>93</sup>

109. TRI engages in a variety of R&D and product development activities, including design of alternative local network architectures, development of new AIN services, design of broadband infrastructure and services, and testing of new services and equipment. Historically, TRI has been involved in the development and testing of a wide variety of new products and services including AIN services (such as custom call routing services), the development of technical requirements for Dense Wavelength Division Multiplexing (which increases the

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<sup>91</sup> Sprint Petition, p. 65.

<sup>92</sup> Carlton and Perloff, *Modern Industrial Organization*, 2nd edition, Chapter 17.

<sup>93</sup> Connecticut DPUC Opinion, Docket No. 98-02-20, ¶29, September 29, 1998.



capacity of fiber optic systems), and the development of Internet Protocol Virtual Private Network services.

110. While Ameritech does not have an organization that is parallel to TRI and undertook a significant restructuring and reduction in force in its R&D operation in recent years, it undertakes significant R&D activities both in-house as well as through outside contractors and suppliers.<sup>94</sup> SBC expects that the merger will enable the realization of synergies in combining the firm's research and development talents and will allow the benefits of these activities to be diffused rapidly to a larger base of customers.

**B. THE TRANSACTION IS LIKELY TO ACCELERATE THE DEPLOYMENT OF SUCCESSFUL PRODUCTS INTO NEW TERRITORIES.**

111. The merger is also likely to result in the more rapid deployment of new products and services. For example, Asynchronous Digital Subscriber Line (ADSL) technology is a potentially significant new service for which deployment is likely to be accelerated by the proposed transaction.

112. ADSL greatly increases the transmission capacity of standard copper wires that serve the vast majority of residential and business customers. The explosive demand of high speed Internet access is expected to create a significant demand for ADSL service in coming years. One industry publication recently wrote:

ADSL is ready for prime time and is well positioned to make the transition from moderate-scale rollouts for business customers to wide scale mass market deployments . . . The major market driver for ADSL today is the tremendous pent-up demand for affordable, high-speed connections to the Internet and company networks.<sup>95</sup>

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<sup>94</sup> Conversation with Jason Weller, Director of Corporate Strategy for Ameritech.

<sup>95</sup> America's Network, August 1, 1998.

113. While ADSL technology is common to SBC and Ameritech, SBC appears to have developed significant know-how in wide scale deployment of ADSL that is likely to be of value to customers in Ameritech's region.

114. Prompted in part by strong demand for high-speed Internet access in California, SBC has deployed ADSL in 87 central offices in California, potentially serving over 4.4 million residential and 650,000 business customers.<sup>96</sup> This wide scale deployment gives SBC significant experience relating to network management, provisioning, maintenance and repair, designing service offerings and pricing. In Texas, SBC began a market trial in Austin in late 1997 and plans to deploy ADSL in the first through third quarters of 1999 to all of its 271 central offices in Texas, Arkansas, Missouri, Kansas and Oklahoma.

115. In contrast, Ameritech has only a limited deployment of ADSL and has cut back on its planned deployment. Currently, Ameritech offers ADSL service only in Ann Arbor, Royal Oak, MI and Wheaton, IL. Ameritech has also installed ADSL capabilities but is not yet offering services in four additional Michigan central offices.<sup>97</sup> Late last year, Ameritech had planned to offer ADSL in 69 central offices by the end of 1998. Instead, services will be available only in nine central offices by that date. Ameritech had planned on deploying facilities in 10 additional central offices per month, but no longer has a firm deployment schedule.<sup>98</sup>

116. Given these circumstances and history, it is likely that SBC's know-how will enable ADSL to be deployed more rapidly throughout the Ameritech states. In its order approving the SBC/SNET merger, the Connecticut DPUC reached a similar conclusion:

As evidence of SBC's technological suitability and responsibility, the Department finds that SBC and its operating companies are committed to a modern, advanced telecommunications infrastructure . . . SBC has also undertaken extensive consideration of ADSL technology, and recently announced a

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<sup>96</sup> Newsbytes, September 1, 1998; SBC Press Release, May 27, 1998.

<sup>97</sup> These central offices are Troy, Auburn Hills, Livonia and Birmingham.

<sup>98</sup> Conversation with Mark Hubscher, Director (ADSL) for Ameritech.

major deployment of ADSL technology in California and in Texas.<sup>99</sup>

117. There are additional areas in which the merger is likely to result in the more rapid deployment of SBC services in Ameritech's territory and Ameritech services in SBC's territory.

For example:

- SBC, through TRI, has participated in the development of a new global position satellite (GPS) technology for monitoring the location of its more than 10,000 repair trucks and for using this information in dispatching and routing in maintenance and repair operations. This system is currently being tested in SBC's territory and SBC estimates that the system will reduce the costs of its mobile maintenance and repair operations by \$30 million to \$40 million annually. I understand that no other telephone company has deployed a comparable technology for tracking and managing its truck fleets. While SBC expects that this system eventually will be offered commercially to third parties, the merger will enable this system to be rapidly deployed throughout Ameritech's territory.
- Ameritech has successfully deployed Privacy Manager, an AIN-based service that blocks calls from callers who do not convey Caller ID information along with their calls (e.g., telephone solicitations).<sup>100</sup> I understand that Ameritech is the first RBOC to develop and deploy this type of product and that Ameritech has applied for patents for this service. Privacy Manager was introduced at the end of September and promises to be very successful, having gained 150 percent more subscribers than anticipated by this date.<sup>101</sup> The merger would enable the service to be deployed rapidly in SBC's territory.

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<sup>99</sup> Opinion, Connecticut DPUC, Docket No. 98-02-20, p. 43, September 2, 1998.

<sup>100</sup> Ameritech Press Release, September 22, 1998. <<http://www.ameritech.com/media/releases/release-1628.html>>

<sup>101</sup> Conversation with Rex Bull, Director of Call Manager Services at Ameritech.

- Ameritech has developed a number of other AIN-based services that are also likely to benefit SBC consumers. These include implementation of an enhanced 911 system used by the City of Chicago that delivers callers' names and addresses which is used to facilitate dispatches of police and fire services, and implementation of a 311 service (a non-emergency 911 system).<sup>102</sup>
- In addition, Ameritech has developed a system that CLECs can use in provisioning the Ameritech AIN services they resell. This "Global SMS" system enables CLECs to use the same software in provisioning AIN services based on different manufacturers' equipment. With this interface, CLECs will not need different systems to provision AIN services based on Lucent and Ericsson equipment (the two types of AIN platforms operated by Ameritech). I understand that this technology could be adapted to SBC's Bellcore-based AIN system, further simplifying CLECs' ability to provision multiple types of AIN platforms.<sup>103</sup>

## CONCLUSION

118. AT&T, MCI WorldCom and Sprint deny that the proposed transaction will benefit consumers and claim instead that consumers will be harmed. The opposition of these firms, as well as other CLECs, is understandable. The proposed merger of SBC and Ameritech will create a significant new provider of packages of telecommunications services serving customers around the nation on an end-to-end basis. AT&T, MCI WorldCom and Sprint are the only firms that have achieved, or are attempting to achieve, the scale and scope that SBC and Ameritech seek in order to efficiently provide these services.

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<sup>102</sup> Conversation with Joe Luby, General Manager, Computer Security/Reliability and Walter Malinowski, Director, Service Assessment and Development, both of Ameritech.

<sup>103</sup> Ibid.

119. Opponents argue that the proposed merger is not necessary to achieve the scale and scope necessary to provide such services, claiming that SBC and Ameritech would undertake significant out-of-region entry in the absence of the proposed transaction. Opponents present no evidence to support this claim. Instead, the fact remains that neither SBC, Ameritech nor any other RBOC had attempted such a strategy absent the proposed transaction. Even if, contrary to available evidence, both SBC and Ameritech would have attempted to deploy out-of-region facilities on a large-scale basis, the proposed transaction benefits consumers by greatly accelerating this process.

120. Much in the way that AT&T's merger with TCG and its proposed merger with TCI, and WorldCom's mergers with MCI, MFS, Brooks, UUNet and others helped them achieve the scale and scope necessary to offer packages of services nationally on an end-to-end basis, this merger will enable SBC/Ameritech to compete in providing packages of telecommunications services nationally. The entry of SBC/Ameritech may harm opponents to the merger, but will benefit consumers.